THE INVESTMENT ASSOCIATION

CONDUCT IN FINANCIAL SERVICES

Practical Insights and Learnings

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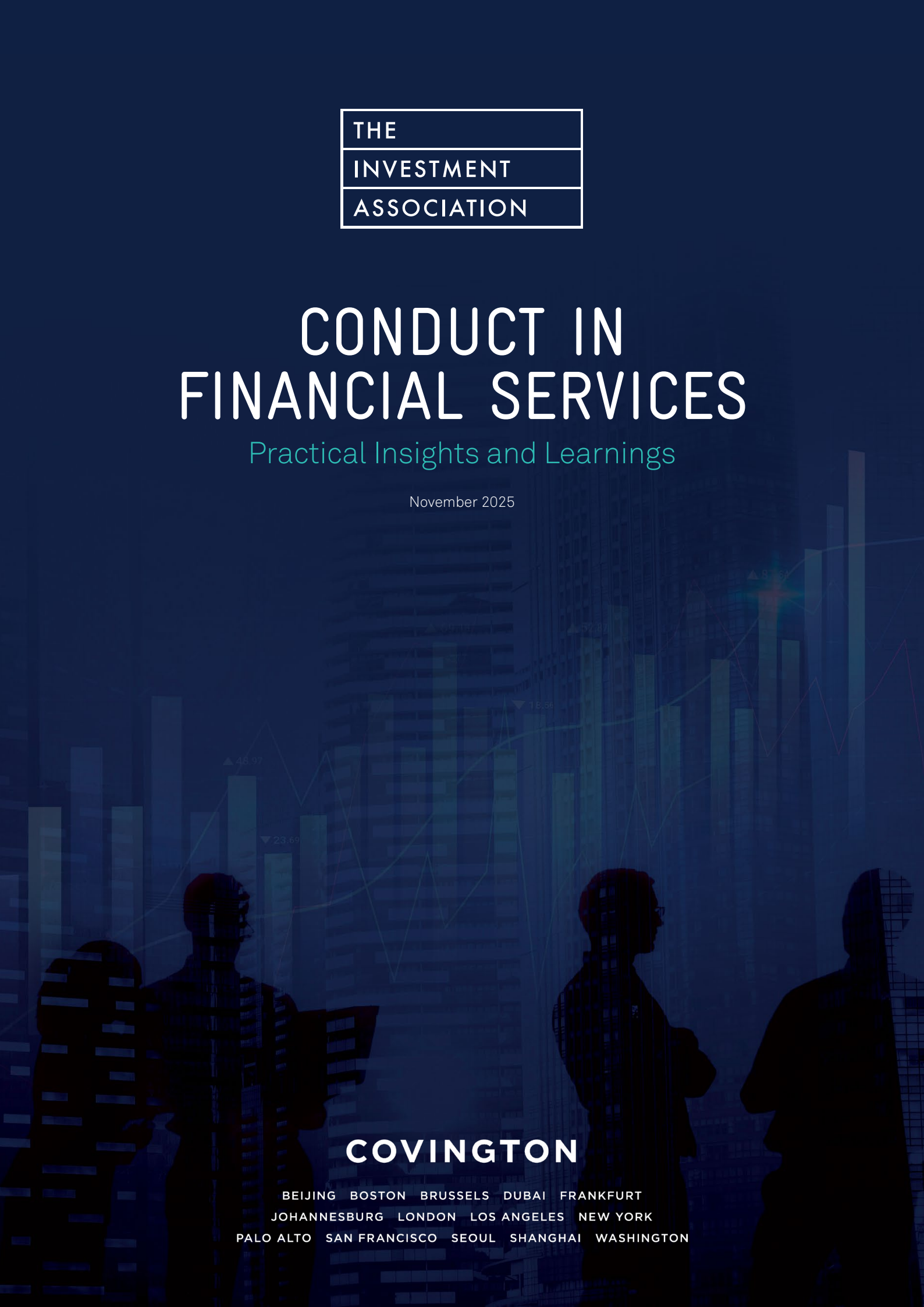

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FOREWORD

Conduct lies at the heart of trust. The way firms and individuals behave towards clients, markets and each other defines not only outcomes for stakeholders but also the integrity and sustainability of the financial system itself. That is why conduct remains a regulatory priority and an area of substantive focus to firms. Yet, as the regulatory and operational landscape continues to evolve in this area, most notably around non-financial misconduct, the practical challenge of translating good intent into consistent, principled behaviour remains significant.

This guide is designed to help firms synthesise the breadth of rules, cases and guidance into practice through tangible and operationally workable tools, enabling them to reduce the risk of conduct issues from arising and to respond effectively when they do.

We are grateful to Covington for their partnership in this valuable resource. Their deep financial services experience across conduct, ethics and culture related matters, combined with practical insights drawn from their extensive work with financial institutions, has been invaluable in shaping its development.

We hope that you find this guide helpful in strengthening governance and accountability and mitigating conduct risk.

Karis Stander

Director, Culture, Talent & Inclusion, MD, Investment20/20

ABOUT THE IA

The Investment Association champions UK investment management, supporting British savers, investors and businesses. Our 250 members manage £10 trillion of assets and the investment management industry supports 124,800 jobs across the UK. Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs. The UK is the second largest investment management centre in the world, after the US and manages £5.1 trillion on behalf of overseas clients.

OVERVIEW

Sub-standard conduct – whether ill-intentioned, inappropriate, inadvertent or innocent – can present a risk of harm to clients, the financial markets, competition, employees and an institution's hard-fought reputation. In practice, many financial institutions will calibrate their definitions of "conduct risk" (and related frameworks) accordingly.

Conduct and ethics in the financial services industry continue to feature prominently on global regulatory agendas – often, alongside institutional culture. Technical conduct rules, codes and expectations may vary across regimes – however (and unsurprisingly), underlying principles and objectives are substantively similar. Accordingly, while this resource is targeted at the UK financial services industry, many aspects and learnings can be applied on a global basis.

This publication draws upon our deep experience of counselling financial institutions on conduct, ethics and culture-related matters and investigations. It is intended as an instructive and practical resource – which is likely to be of particular interest to Conduct or Ethics, Culture, Legal, Compliance, HR, Governance, Accountability and Risk functions within financial institutions.

All insights, learnings and 'war-stories' referenced in this publication are based on, or informed by, real experiences.

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1. INTRODUCTION

Over the past two decades, in the wake of numerous high-profile financial markets scandals and governmental bail-outs, a host of conduct, culture and accountability-related regulatory initiatives have been implemented across global financial centres.

In the conduct and accountability contexts, the UK's Financial Conduct Authority ("**FCA**") is widely-regarded as having paved the way – most notably, with the introduction of the Senior Managers and Certification Regime ("**SMCR**"), which has accountability and (broadly-applicable) conduct standards at its heart. Similar accountability regimes have since been introduced in Singapore, the Netherlands, Australia, and Ireland, amongst other nations.

Various international bodies, such as the influential ***Group of 30***, have issued a range of publications on the importance of instilling and embedding a healthy institutional culture – fostering a general regulatory expectation that culture and cultural trajectory are systematically measured and monitored, and subject to appropriate levels of governance and oversight. Notably, the FCA has brought several successful enforcement actions over recent years – against both firms and individuals – which have been underpinned by findings of misconduct and/or poor culture.

OBJECTIVE AND APPLICATION

This publication consolidates and synthesises a host of conduct-related insights and learnings in the context of the UK financial services industry. It aims to distil the relevant rules, cases, guidance and proposals down to an essential core – intended to inform and facilitate, from a concertedly practical perspective, institutional approaches to conduct.

While this resource is notionally focused on the UK financial services regulatory regime, much of the substantive content and guidance will have global relevance and application.

OUTLINE

Section 2 briefly addresses the interplay and interconnectivity between conduct, culture and values.

Section 3 sets out the relevant regulatory backdrop – covering the Conduct Rules, Fitness and Propriety requirements and non-financial misconduct ("**NFM**").

The important topic of the 'reasonable steps' standard applicable to senior managers is considered in *Section 4*.

Finally, *Section 5* provides a range of practical insights and pointers – covering topics, including: consequences frameworks; out-of-office conduct; tone from above; training; and conduct governance.

Annexes 1 and *2*, respectively, contain **practical flow-charts** to facilitate internal decision-making in relation to NFM and notification obligations, each with accompanying notes and guidance. These flow-charts represent a distillation of applicable rules, presented in a user- friendly format.

2. CONDUCT, CULTURE AND CORPORATE VALUES – AN IMPORTANT 'TRILOGY'

Most firms promote **corporate values**, which are commonly highlighted on websites, intranets and in promotional literature. Values such as 'client-centricity', 'integrity', 'accountability', 'transparency' and 'respectfulness' will often feature.

Importantly and realistically, these values will only be achievable in practice through good and ethical conduct.

Conduct and **culture** are intertwined – the latter serving as the environmental backdrop against which conduct and behaviours occur. It follows that a healthy culture should facilitate the attainment of espoused values. Conversely, a poor culture may well render these values unachievable, in practice. The Investment Association's ***'A Practical Framework for Enduring Change (2025)'*** contains a host of practical insights on the measurement and monitoring of culture and cultural trajectory.

Values, conduct and culture are (or, at least, should be), therefore, inextricably linked. In our experience, many firms fail to expressly draw out this intertwined 'trilogy' – with corporate values (and their relevance) often conspicuous by their absence within Conduct or Ethics Codes / Handbooks or Conduct Risk Policies.

By cross-referencing (and explaining the interconnectivity of) the firm's corporate values within conduct-related policies, training and frameworks, firms present their employees with a coherent picture – illustrating how values, conduct and culture are tied together, and facilitating a strong, well-embedded, appreciation of their importance.

3. REGULATORY BACKDROP

A. FCA CONDUCT RULES (COCON)

Virtually all employees must comply with a set of 6 core *Conduct Rules*:

Rule 1: *You must act with integrity.*

Rule 2: *You must act with due skill, care and diligence.*

Rule 3: *You must be open and cooperative with the FCA, the PRA and other regulators.*

Rule 4: *You must pay due regard to the interests of customers and treat them fairly.*

Rule 5: *You must observe proper standards of market conduct.*

Rule 6: *You must act to deliver good outcomes for retail customers.*

Senior Managers (i.e. those with a senior manager function designation or "**SMF**") must additionally comply with 4 *Senior Manager Conduct Rules* (SC1 to SC4):

SC1: *You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.*

SC2: *You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.*

SC3: *You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.*

SC4: *You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.*

The FCA provides a non-exhaustive list of examples of conduct that would be deemed to be in breach of the Conduct Rules (*see here*) and the Senior Manager Conduct Rules (*see here*).

Note: Meaning of Integrity

In law, integrity is a broader concept than honesty – whereby the former encapsulates **reckless conduct**, whereas dishonesty does not. A person's conduct may therefore fall short of dishonesty and yet demonstrate a lack of integrity, through acting recklessly. The test for **recklessness** has both subjective and objective elements:

"The subjective element requires a finding that the person concerned appreciates that there is a risk that a relevant circumstance exists or that a relevant result may occur; the objective element requires a finding that it was unreasonable for them to take that risk. To put it succinctly, someone who runs an unreasonable risk of breaching regulatory obligations is acting recklessly."

NON-FINANCIAL MISCONDUCT (NFM)

NFM, including bullying, harassment and discrimination, has been identified by the FCA as being a clear indicator of a toxic culture – with the occurrence of NFM raising questions about a firm's ability to make sound decisions and manage risk appropriately.[1]

The FCA's recent consultation paper on NFM, ***CP25/18***, proposes some additional specific (and detailed) COCON guidance in the context of NFM – see pages 64 to 70 (inclusive) of 82.

CP25/18 also introduces a new rule,[2] effective 1 September 2026, which extends the relatively narrow current application of COCON (i.e. to regulated activities only) for non- banks to cover (broadly) NFM perpetrated against a colleague in a work-associated environment:

COCON 1.1.7FR

(3) COCON applies to the conduct of a member of the conduct rules staff of a firm (Firm A) of a kind described in (4) in relation to any of the following individuals:

- *(a) an employee of Firm A or of a member of its group;*
- *(b) an individual who performs a function of Firm A or of a member of its group;*
- *(c) an individual who provides services to Firm A or to a member of its group;*
- *(d) an employee of a person who provides services to Firm A or to a member of Firm A's group;*
- *(e) an individual who performs a function of a person who provides services to Firm A or to a member of Firm A's group; or*
- *(f) an individual when performing an activity that forms part of an activity of Firm A.*

(4) The kind of conduct to which this rule applies as referred to in (3) is unwanted conduct of the following kinds in relation to an individual referred to in (3) ('B'):

- *(a) conduct that has the purpose or effect of:*
  - *(i) violating B's dignity; or*
  - *(ii) creating an intimidating, hostile, degrading, humiliating or offensive environment for B; or*
- *(b) conduct that is violent to B.*

CP25/18 proposes detailed new guidance[3] relating to this rule, including a stipulation that only '**serious**' conduct is within scope. The guidance on the interpretation of seriousness, in this context, is extracted below:

4.1.8EG *COCON 1.1.7FR only covers conduct that is serious. The factors that the FCA will take into account when deciding whether misconduct in relation to a fellow member of the workforce is serious enough to amount to a breach of COCON include:*

- *(1) whether the conduct is repeated or part of a pattern;*
- *(2) the duration of the conduct;*
- *(3) the size of the impact on the subject of the conduct (the rule applies to effects which are serious and marked, and not to those which are, though real, of lesser consequence);*
- *(4) the seniority of the person whose conduct is in question;*
- *(5) the difference in seniority between the person whose conduct is in question and the subject of the conduct and whether the person whose conduct is in question has control or influence over the other's career;*
- *(6) whether the subject of the misconduct has specific characteristics or vulnerabilities, particularly if this is a factor in the conduct in question;*
- *(7) whether the person whose conduct is in question has been warned or disciplined for similar conduct by the firm, a previous employer, the police or a regulator;*
- *(8) whether the person whose conduct is in question has previously undertaken not to do the act or engage in the behaviour in question; and*
- *(9) whether the conduct is criminal or would justify dismissal.*

Annex 1 contains a **practical flowchart**, distilled from the relevant provisions of CP25/18, which is intended to facilitate determinations as to whether behaviour amounting to NFM may constitute a breach of COCON in any given circumstance. The flowchart has been prepared on the assumption that the finalised guidance will not deviate significantly from that proposed in CP25/18.

CONTEXTUAL CONSIDERATIONS

In assessing compliance with, or a breach of, a rule in COCON, the FCA will {and, consequently, firms should} have regard to the context in which a course of conduct was undertaken, including: (1) the precise circumstances of the individual case; (2) the characteristics of the particular function performed by the individual in question; and (3) the behaviour expected in that function.

PERSONAL CULPABILITY

A person will only be in breach of any of the rules in COCON where they are **personally culpable**. Personal culpability arises where: (1) a person's conduct was deliberate; or (2) the person's standard of conduct was below that which would be reasonable in all the circumstances. In practice, this requirement is often interpretated as the point at which any mitigating circumstances should be taken into account.

In determining whether or not the conduct of a senior conduct rules staff member complies with rules SC1 to SC4 in COCON, the FCA would expect a firm to take into account the following (inexhaustive) list of factors:

(1) whether they exercised reasonable care when considering the information available to them;

(2) whether they reached a reasonable conclusion upon which to act;

(3) the nature, scale and complexity of the firm's business;

(4) their role and responsibility as determined by reference to the relevant statement of responsibility; and

(5) the knowledge they had, or should have had, of regulatory concerns, if any, relating to their role and responsibilities.

REASONABLENESS

In assessing whether a Senior Manager (SMF) may have breached a rule in COCON, the nature, scale and complexity of the business and the role and responsibility of the individual undertaking the activity in question within the firm will be relevant in assessing whether that person's conduct was **reasonable**. For example, the smaller and less complex the business, the less detailed and extensive the systems of control need to be.

The important topic of 'reasonable steps' is addressed in *Section 4 below*.

CONDUCT RULE BREACH DETERMINATIONS

Many firms adopt a (typically documented) process for determining whether a Conduct Rule breach has occurred in a given situation. This process should encompass and reflect the above elements and considerations – to ensure that Conduct Rule breach decisions are taken on a technically-correct and proper basis in alignment with the applicable rules and guidance. Commonly, Conduct Rule breach assessments are undertaken by a small committee of stakeholders from across some, or all, of Legal, Compliance, HR and Conduct functions within a firm.

[1] *IA Culture is contagious | FCA*
[2] COCON 1.1.7FR.
[3] COCON 4.1.8EG to COCON 4.1.8KG.
[4] COCON 3.1.5G.

In practice, when faced with a potential misconduct incident requiring investigation, most firms will follow the following sequence of events:

(1) In the first instance, the firm will undertake a disciplinary investigation to establish whether a formal disciplinary process is warranted.

(2) If so, and whether or not this ultimately culminates in a disciplinary action (as defined in ***Section 3d***, the firm will (and, indeed, should routinely) go on to consider[5] whether a Conduct Rule has nevertheless been breached.

(3) If so, a regulatory notification obligation on the firm may arise. ***Section 3d***, together with the flow-chart in ***Annex 2***, outlines the various notification obligations that must be borne in mind in this context.

AWARENESS AND TRAINING REQUIREMENTS

Firms are required to: (i) ensure that all relevant persons are notified of applicable conduct rules; and (ii) take reasonable steps to ensure that those persons understand how the rules apply to them. In practice, these steps will necessarily involve suitably-tailored training – to ensure adequate levels of understanding and awareness across the firm. This includes the training of senior management, who must ensure that they follow – in letter and spirit – all applicable firm conduct-related policies and procedures.

The FCA has provided the following examples, indicating its expectations of firms:[6]

Positive Indicators	Negative Indicators
Relevant SMF can demonstrate appropriate involvement in/oversight of training	Relevant SMF has limited knowledge of training approach and/or has delegated with limited oversight
Training is interactive and uses realistic scenarios	Simple computer-based training only – with little attempt to tailor to role
Examples/scenarios draw out nuances of how the rules apply to each type of role	Training only gives obvious examples of breaches – for example, fraud or not attending mandatory training – which do not draw out nuances
Line managers are involved in training delivery, not just HR or a project team	Training is delivered by a HR, Compliance or a project team with no line management involvement
Training is reinforced regularly and built into on-boarding	Training is a one-off exercise and/or not built into on-boarding
Effectiveness of Conduct Rules training is assessed	No measures of the effectiveness of Conduct Rules training
Training is put in the context of the overall regime	Training is not put in context of the overall regime
Regime/Conduct Rules are presented as a step change in regulatory expectations	Regime/Conduct Rules are presented as nothing new, simply 'what we do already'
Conduct is linked to fitness and propriety and performance assessments	Conduct not linked to fitness and propriety or performance assessments

[5] Ordinarily, on the basis of the facts established and evidenced adduced during the disciplinary investigation.
[6] *Conduct Rules | FCA*

B. FITNESS AND PROPRIETY ("FIT")

Persons may only undertake roles requiring SMF or 'certified' status if they are (at the point of taking on the role), and remain, **fit and proper**.[7] In broad terms, the most important considerations in determining a person's fitness and propriety are there:

> *(1) honesty, integrity and reputation;*
>
> *(2) competence and capability; and*
>
> *(3) financial soundness.*[8]

The FCA provides helpful ***general*** and ***specific*** guidance on each of these elements.

The application of FIT is significantly broader than that of COCON. In essence, FIT applies, in principle, to all relevant events and circumstances, wherever they may have taken place and including within a person's personal or private life. According to the FCA, misconduct in a person's private or personal life or in their working life outside the regulatory system may be relevant to their fitness and propriety even if there is little or no risk of it being repeated in their work for their firm.[9] Conduct in a person's personal or private life may be relevant if:

> *(a) it demonstrates a willingness to:*
>
> *(i) disregard ethical or legal obligations;*
>
> *(ii) abuse a position of trust; or*
>
> *(iii) exploit the vulnerabilities of others; and/or*
>
> *(b) it is sufficiently serious such that, were the person permitted to work at a firm, it could undermine public confidence in the regulatory system (or any part thereof) or otherwise impact the FCA's statutory objectives.*[10]

Generally, a firm is not required to actively monitor the private lives of staff that are subject to the standards in FIT, for the purposes of determining their ongoing fitness and propriety. This extends to the monitoring of a person's social media activity – the FCA has confirmed that a person can lawfully express views on social media that are controversial or offensive, without calling into question their fitness and propriety, even if a colleague is upset by those views.[11] A firm need only look into the private life of a person if there is good reason to do so – for instance, if the firm becomes aware of an allegation which, if true, would call into question their fitness under FIT.[12] This may include where the firm is made aware of a relevant staff members social media activities, which indicate that the person is breaching (or may breach) standards of the regulatory system, e.g. through threats of violence, or indications of support or involvement in criminal activities.[13]

FRENSHAM COMPATIBILITY

In the FCA's view, misconduct of the type in FIT 1.3.17G can mean that the person concerned is not fit and proper **even if it cannot be shown** that the misconduct will, by itself, cause direct and discernible damage to public confidence in the financial system and financial services industry in the UK or to confidence in their firm on the part of customers or those who deal with the firm. As with other kinds of misconduct (see FIT 1.3.13G), it is sufficient if the misconduct is of a type that is inconsistent with the FCA's statutory objectives.[14]

However, the underlined wording above appears to be at odds with the Upper Tribunal findings in Frensham v FCA [2021]. In Frensham, the Upper Tribunal criticised the FCA for making "speculative and unconvincing" attempts to link Mr Frensham's personal lack of integrity to his professional integrity. The Upper Tribunal was critical of the FCA's attempts to equate general moral failings with regulatory unfitness without establishing a sufficient evidential nexus to Mr Frensham's professional role or the statutory objective of maintaining public confidence.

[7] Section 60A(1) and Section 63F of the Financial Services and Markets Act 2000.
[8] FIT 1.3.1BG.
[9] FIT 1.3.17(1)G, CP25/18.
[10] FIT 1.3.17(1)G, CP25/18.
[11] FIT 1.3.21(4)G, CP25/18.
[12] FIT 1.3.20(1)G, CP25/18.
[13] FIT 1.3.21(4)G, CP25/18.
[14] FIT 1.3.18G, CP25/18.

On the one hand, the FCA's position in FIT 1.3.18G reflects a more expansive and preventative approach, enabling it to act where it believes that conduct (even in one's private life) is inherently incompatible with the integrity required of financial services professionals to maintain public confidence in the financial system and financial services industry. On the other hand, the Upper Tribunal's decision reflects a more constrained legal standard – one requiring that a clear evidential link be shown between the misconduct and statutory objective to maintain public confidence. Notably, the FCA appears to have disregarded the Upper Tribunal's guardrails in Frensham and, instead, adopted this more expansive interpretation in the subsequent ***Zahedian*** case (which was not appealed).

While FIT 1.3.18G signals the FCA's intent to widen its scope of review concerning personal integrity, firms should remain mindful that enforcement action will (if appealed) ultimately be subject to the oversight of the Tribunal, which we assume would follow its own findings in Frensham.

C. LINK BETWEEN COCON AND FIT

While there is a degree of underlying substantive overlap between the COCON and FIT regimes – for instance, with the concept of **integrity** featuring prominently in both – they are technically distinct.

A breach of COCON will not necessarily result in a finding that the perpetrator is no longer fit and proper. In CP25/18, the FCA proposes some helpful new guidance on factors that will be relevant to this question, including, amongst others:

(1) the seriousness of the breach, taking into account matters such as the following:

(a) whether the breach involved dishonesty, breach of trust or violence;

(b) whether the individual knew that their conduct was a breach of COCON or their firm's internal requirements but carried on the conduct anyway;

(c) vulnerability of those affected by the breach;

(d) whether the breach was of Individual Conduct Rule 1 (You must act with integrity), although not every breach of that rule means that the individual is unfit;

(e) the harm done;

(2) the seniority of the individual (the fact that the individual held a senior position may make the breach more serious than it would be if they held a junior position);

(3) the likelihood of recurrence of the relevant conduct, for instance whether the conduct was a one-off lapse; and

(4) the relevance of the breach to the role for which the member of staff being assessed under FIT is being assessed.[15]

D. NOTIFICATION OBLIGATIONS

A breach of COCON may trigger one or more FCA notification obligations.

SIGNIFICANT COCON BREACHES

A 'significant' breach of COCON is notifiable immediately to the FCA.[16] "Significance" in this context should be determined having regard to potential financial losses to customers or to the firm, frequency of the breach, implications for the firm's systems and controls and if there were delays in identifying or rectifying the breach.[17]

[15] FIT 1.3.10G.
[16] SUP 15.3.11(1)(a)R.
[17] SUP 15.3.12G.

OTHER COCON BREACHES

Where a firm has taken 'disciplinary action' against a person in connection with that person's breach of COCON, this must be notified to the FCA.[18] For SMFs, the notification must be made within 7 days. For others, it must be included in the firm's relevant annual regulatory report (REP008).

In this context, disciplinary action against a person means: the issuing of a formal written warning, the suspension or dismissal of that person or the reduction or recovery of any of such person's remuneration.[19]

In its recent consultation paper on SMCR, ***CP25/21***, the FCA is proposing to qualify[20] this definition in the following circumstance: If an employee is suspended pending the investigation of possible misconduct, there will be no reporting obligation. That is because the reason for the action will not be a breach of COCON but instead the need to investigate misconduct. This is the case even if the misconduct for which the employee is being investigated would be a breach of COCON. Similar guidance is also proposed in relation to a precautionary reduction of compensation.[21]

FITNESS AND PROPRIETY CALLED INTO QUESTION

If a firm becomes aware of information which would reasonably be material to the assessment of the fitness and propriety of an SMF, or a potential SMF, it must inform the FCA as soon as practicable and, in any case, within 7 business days.[22]

This FIT-related notification obligation is separate to the above COCON-related notification obligations.

PRINCIPLE 11

For completeness, each of the above notification requirements are independent of a firm's general obligation under Principle 11: *"A firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice".*

In practice, however, it is difficult to conceive of a scenario in which notification is not required under the above rules, but is nevertheless notifiable under Principle 11.

NOTIFICATIONS DECISION-TREE

Annex 2 summarises these notification obligations in the form of a schematic – which can be utilised to facilitate decision-making in practice.

REGULATORY REFERENCES

The FCA has expressly clarified[23] that in a circumstance where an employee has breached COCON but the firm has not taken associated 'disciplinary action', the firm need not report that breach in the answer to question G[24] of the ***Regulatory Reference Template*** (or anywhere else in the reference) if the firm reasonably considers it not to be relevant to the assessment by the firm asking for the reference of whether the individual is fit and proper. This clarification reflects the logic that a COCON breach deemed insufficiently serious as to warrant a related disciplinary action will likely not serve to compromise the perpetrator's overall fitness and propriety.

[18] SUP 15.11.
[19] SUP 15.11.5G.
[20] SUP 15.11.6F(3)G.
[21] SUP 15.11.6G(2)G.
[22] SUP 10C.14.18R.
[23] SYSC 22.6.3A(2)G, CP25/18.
[24] *"Are we aware of any other information that we reasonably consider to be relevant to your assessment of whether the individual is fit and proper?"*

4. REASONABLE STEPS

As outlined in the previous section, the concept of **reasonableness** features heavily throughout COCON. SMCR is not a 'strict liability' regime – it does not expect perfection from SMFs. Rather, SMFs are held to a **'reasonable steps'** standard.

It is not possible (or, arguably desirable) to provide a definitive or prescriptive list of 'reasonable steps' – not least, as no two situations will be identical, whether on account of different fact-patterns and/or distinct contextual factors. Notwithstanding, the FCA Handbook contains a host of illustrative (albeit non-exhaustive) examples and guidance in this regard – in particular:

- *COCON 4.2*
- *DEPP 6.2*

CASE STUDY

In one of the relatively few SMCR-related enforcement cases to-date, and arguably the most instructive, the Prudential Regulation Authority ("**PRA**") fined *Mr Carlos Abarca*, the former Chief Information Officer ("**CIO**") of TSB Bank plc ("**TSB**"), £81,620 for breaching PRA Senior Manager Conduct Rule 2 – as he failed to take reasonable steps to ensure that TSB adequately managed and appropriately supervised its outsourcing arrangement in relation to its 2018 IT migration programme. This followed on closely from the enforcement action taken in December 2022 against TSB for operational resilience failings, which resulted in a joint financial penalty of £48,650,000 imposed by the PRA and FCA.

As CIO of TSB, Mr Abarca had responsibility for TSB complying with the PRA's outsourcing rules. In particular, he was responsible for TSB's key outsourcing relationship with its main third-party supplier for the IT migration programme. As part of this, he gave assurance to the TSB Board that the third party, as key supplier, was prepared for migration. However, he failed to ensure that TSB had, itself, obtained sufficient assurance from the third party before doing so.

The PRA's investigation found that Mr Abarca had breached the PRA's Senior Manager Conduct Rule 2 because he had **failed to take reasonable steps** to ensure that TSB complied with the PRA Outsourcing Rules. In particular, Mr Abarca did not:

- ensure that the third party's ability and capacity were adequately reassessed on an ongoing basis;
- ensure that TSB obtained sufficient assurance from the third party in relation to its readiness to operate the new IT platform; and
- give sufficient consideration to whether further investigation was required before giving assurance to the TSB Board as to the third party's readiness for migration.

> *"The action which the PRA has taken emphasises the importance of ensuring that senior individuals in a firm take reasonable steps to ensure that the firm complies with the relevant regulatory requirements and standards, in compliance with Senior Manager Conduct Rules."*
>
> *"Mr Abarca had specific migration-related responsibilities for TSB's outsourcing relationship with SABIS [the main third-party supplier]. The PRA required him to take reasonable steps to ensure effective management of the migration process, including identifying and mitigating risks from an IT perspective. The PRA required him to take reasonable steps to ensure TSB's compliance with the PRA's Outsourcing Rules, including obtaining sufficient assurance from third party providers to reduce the risk of operational disruption and the potential impact on financial stability."*[25]

[25] Paragraphs 4.4 and 4.7 of the *Final Notice*.

NFM

In CP25/18, the FCA has clarified its expectations regarding a manger's failure to address NFM perpetrated against colleagues in a work-associated environment:

> *A manager will be in breach of Conduct Rule 2, if (s)he fails to take reasonable steps to:*
>
> - *prevent or stop harassment, bullying or similar misconduct if (s)he knows or should know about it;*
> - *implement or operate policies and controls that detect and address non-financial misconduct;*
> - *appropriately investigate complaints and ensure fair outcomes;*
> - *create a workplace where people feel safe to speak up; and*
> - *escalate concerns beyond their function if (s)he lacks authority to act directly.*[26]

GUIDANCE

While there is no 'one-size-fits-all' approach to reasonable steps, in practical terms, it will be important for SMFs to have (at a minimum):

(i) a strong appreciation and understanding of **the scope, essence and import of their regulatory responsibilities**;

(ii) a good sense as to the **enforcement risks inherent** within those responsibilities – in other words, that they have identified the key potential non-compliance risks within their area(s) of responsibility;

(iii) implemented a (regularly reviewed) **sound and effective control framework** around the risks identified under (ii);

(iv) (and maintain) an appropriate degree of oversight and visibility over the operation and control of their area(s) of responsibility – which will likely be effected through (amongst other things):

(a) Periodic management information and routine reporting;

(b) Committee papers / packs;

(c) Periodic meetings with delegates and direct reports (ideally, followed up with a documented summary);

(d) Attendance at relevant committee / board meetings;

(e) Incident reporting (where necessary);

(f) Relevant FCA / regulatory correspondence,

(v) a strong and **up-to-date knowledge and appreciation of the prevailing legal and regulatory environment** – to ensure that decisions are made on a properly-informed basis, for example, taking into account any particular regulatory 'hot issues' which may affect the overall risk calculus.

PRACTICALITIES

Many SMFs have benefited from a combination of **individual risk assessment workshops** and **'war-gaming' sessions** – which have proven to be effective in focusing minds and sharpening priorities. Typically, these sessions are 'reverse engineered' from an SMF's Statement of Responsibilities, using plausible assumed FCA-notifiable incidents, which are then played through from an FCA enforcement perspective. This, in turn, involves identifying the FCA's likely avenues of challenge for the SMF; and, crucially, what demonstrable (ideally, contemporaneous) reasonable steps the SMF could point to – in rebuttal of the FCA's allegation / premise – in the face of such challenge. Any gaps identified are then remedied accordingly.

[26] COCON 4.1.8-AG and COCON 4.1.8-BG.

5. PRACTICAL INSIGHTS AND POINTERS

A. OUT-OF-OFFICE MISCONDUCT

As we have seen, from a technical perspective, out-of-office misconduct is more likely to be potentially relevant in a FIT (as opposed to COCON) context. However, irrespective of the technical position, no right-thinking firm will want to suffer from reputational damage that may flow from an employee's out-of-work misconduct. As a practical matter, firms would therefore be well-advised to check that their relevant Codes of Conduct / Ethics (or equivalent) include a provision to the effect that all employees, interns, contractors, etc., are expected to conduct themselves – both in and out of the workplace – in a manner that does not cast doubt over their integrity or reputation, or that of the firm.

B. BYSTANDER EMPLOYEE SCENARIOS

Scenario: On her way to work, an employee witnesses a colleague jumping the ticket barriers at the train station.

Questions:

- *What, if anything should the bystander employee do?*
- *Does the firm articulate its expectations of employees in such 'bystander' situations?*

Commentary: Scenarios such as this will occur from time to time – and they can often prove both tricky and awkward.

Some firms expressly mandate that the bystander employee must report the incident to HR or Compliance (as appropriate). Other firms "strongly recommend" or "urge" such reporting. Notably, a significant proportion of firms do not account for these kinds of scenarios within their conduct policy suite – leaving employees unclear as to what (if anything) is expected of them.

C. CONCERTED FOCUS ON CONDUCT AND ETHICS WITHIN THE RECRUITMENT PROCESS

Recruitment processes tend to centre on the candidate's experience, credentials and technical expertise. Until relatively recently, there was little, if any, concerted focus on values, ethics and moral compass.

This tide has started to turn, with some firms now routinely incorporating values assessments into their hiring processes. Similarly, recruitment literature and advertisements also now commonly reference culture and values.

While, of course, no method will be entirely watertight, a technique now commonly employed is the use of one or two thorny ethical dilemma scenarios, on which candidates are asked for their views. While there may not be a "right" answer as such, the manner in which a candidate views and addresses an issue may be indicative of whether their values are likely to be aligned with the firm's values and culture. By way of example, the above employee bystander case study could be utilised in this context.

D. TRAINING

Over recent years, there has been a discernible trend towards regular in-person conduct training – during which attendees are afforded the opportunity to engage, challenge and pose questions.

Increasingly, training will incorporate tricky and tailored 'real-life' scenarios, often including difficult moral dilemmas. Content that highlights a potential conflict of personal versus organisational interests has proven to be particularly effective. For instance, scenarios that draw out any distinction between what a person *would* (out of a desire to self-protect or out of convenience) be inclined to do in the circumstances; and what they *should* (ethically, and in the firm's and its clients' interests) do.

E. LEADING BY EXAMPLE / TONE FROM ABOVE

The importance of managerial role-modelling cannot be overstated. Whether they realise it or not, employees look to more senior colleagues for behavioural cues. It is therefore imperative that the tone set by managers (at all levels) aligns with the firm's espoused values and the spirit of Conduct / Ethics Codes.

Observed good practices include:

- *Visible (and authentic) sponsorship of conduct and culture-related initiatives (including training)*
- *Leading by example*
- *Empathy and responsiveness*
- *Demonstrable receptiveness to feedback and challenge*
- *An evident personal commitment to high conduct standards*

Conversely, a commonly experienced bad practice is conveying an impression that management does not practise what they preach. This will often result in a sense of resentment, mistrust and general disengagement amongst more junior staff.

F. (POSITIVE AND NEGATIVE) INTERNAL CASE STUDIES

Some firms will pro-actively take the opportunity to communicate (typically anonymised) recent conduct-related case studies exemplifying good or poor conduct – for instance, through town-hall sessions, team meetings or CEO communiques. This has generally proven to be an effective and thought-provoking approach – serving to focus minds with relatable 'war stories'.

G. CONSEQUENCES FRAMEWORKS

When determining the consequences of misconduct for the perpetrator, firms will necessarily need to strike an (often delicate) balance between, on the one hand, fairness towards the perpetrator from an employment law perspective, and on the other hand, meeting FCA rules and expectations. Put simply, firms will want to be perceived as acting robustly, yet fairly.

Against this backdrop, it is imperative that firms' consequence frameworks (including relevant decision-making processes) are **coherent, fair and consistently applied**.

The FCA adopts the general view that the more senior a person, the commensurately higher the standard of conduct that is expected from them. Accordingly, firms should guard against conveying any impression that senior personnel are afforded more lenient treatment than (more easily-dispensable) junior staff – especially, for example, in situations with similar underlying fact-patterns. Any such perception could well precipitate an adverse line of questioning and cast unhelpful doubts over organisational culture.

H. CONDUCT GOVERNANCE

The FCA will expect that conduct is routinely (and demonstrably) considered at an appropriately senior forum within a firm's governance framework. There is no prescribed committee or "right" approach, as such – although it is noted that a number of firms have established dedicated conduct (or conduct and culture) committees.

It is essential that the body primarily responsible for the formal oversight of conduct receives, consistently, **instructive information and metrics**. In practice, this will often take the form of a **conduct 'dashboard'** that has been thoughtfully calibrated – by reference to the firm's activities, relative risk profile and structure – to encompass key conduct risks. Ideally, conduct-related metrics will be accompanied by **informative commentary** – to put the numbers into context. Sample dashboard metrics might cover, for example (and without limitation) [broken down by area / team]:

- *Number and category of notifiable Conduct Rule breaches*
- *Number and category of non-notifiable Conduct Rule breaches*
- *Mandatory training non-completion rates*
- *Number and characterisation of conduct-related complaints, grievances or whistle-blows*
- *Number and categorisation of conduct-related disciplinary actions*
- *Number of qualified Form Cs submitted (and in respect of which areas of the firm)*
- *Number and characterisation of resignations while under investigation*

Metrics should not, however, be analysed solely on a 'point in time' basis. Rather, it is important that relevant conduct information is presented in a manner that facilitates the identification of any **trends** over time. This should help to ensure, for example, that any potentially concerning emerging risks and/or areas of recurrent non-compliance are identified (and therefore can be addressed) as early as possible.

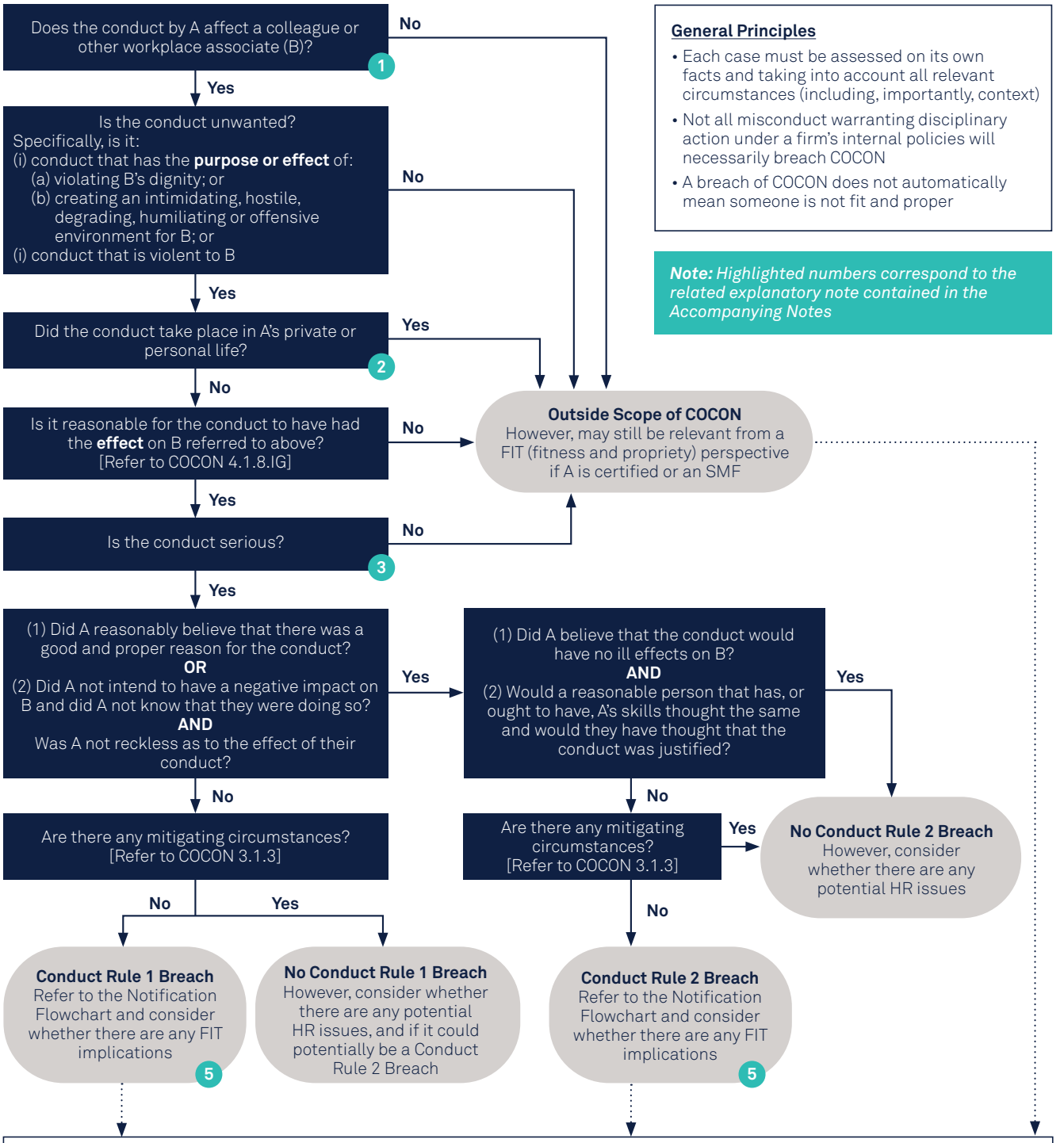
Conduct governance should additionally include oversight of the overall operational efficacy of a firm's conduct framework – which may involve periodic second or third line review and assurance activity.

I. RESPONDING TO ISSUES

A failure by a firm and/or responsible SMFs to address, appropriately, any identified or suspected conduct issues could, itself, be perceived as a regulatory failing. For instance, when an issue arises, firms and responsible SMFs are expected to consider **why** and **how** the issue was allowed to materialise – in other words to seek to determine the underlying root-cause(s) and assess whether any consequent remedial measures need to be implemented.

Similarly, if a manager is put on notice of conduct issues within his or her area of responsibility, then (s)he would be expected to take appropriate action – for instance, to commission an independent review. A failure to respond to a known issue could well be adjudged as a conduct failing in its own right.

ANNEX 1
NFM FLOWCHART AND ACCOMPANYING NOTES



General Principles

- Each case must be assessed on its own facts and taking into account all relevant circumstances (including, importantly, context)
- Not all misconduct warranting disciplinary action under a firm's internal policies will necessarily breach COCON
- A breach of COCON does not automatically mean someone is not fit and proper

***Note:** Highlighted numbers correspond to the related explanatory note contained in the Accompanying Notes*

FIT Considerations

Key question: Is the conduct consistent with the FCA's statutory objective of maintaining public confidence in the financial system and UK financial services industry?

Conduct that can damage such public confidence, either in or outside the workplace, is likely to mean that the individual concerned is not fit or proper [See FIT 1.13.12G, and FIT 1.3.16G to FIT 1.3.18G]

Note: FIT 1.3.18G states that A could be deemed not fit and proper *even if it cannot be shown* that the misconduct will by itself cause direct and discernible damage to public confidence in the financial system and UK financial services industry. This appears to be at odds with the Upper Tribunal's findings in Frensham, where a *clear evidential link* must have been shown between the misconduct and statutory objective to maintain public confidence

4

ACCOMPANYING NOTES:

Note: Each of the following sections corresponds to the related highlighted note in the NFM Flowchart.

1. DEFINING A COLLEAGUE (COCON 1.1.7FR (3))

COCON applies to the conduct of a member of the conduct rules staff of a firm (Firm A) of a kind described in (4) in relation to any of the following individuals:

a) an employee of Firm A or of a member of its group;

b) an individual who performs a function of Firm A or of a member of its group;

c) an individual who provides services to Firm A or to a member of its group;

d) an employee of a person who provides services to Firm A or to a member of Firm A's group;

e) an individual who performs a function of a person who provides services to Firm A or to a member of Firm A's group; or

f) an individual when performing an activity that forms part of an activity of Firm A.

2. THE INTERLINK BETWEEN PRIVATE / PERSONAL LIFE AND COCON (COCON 1.3.7G)

"A" refers to the member of a firm's conduct rules staff carrying out the conduct in question.

Description of Conduct	Does the conduct generally sit within the scope of COCON 1.1.6R to COCON 1.1.7R?
Misconduct by A in relation to a fellow member of the workforce while both are on the firm's premises	**Yes**
Misconduct by A in relation to a fellow member of the workforce while A is working remotely for their firm	**Yes**
Misconduct by A in relation to a family member while A is working remotely for their firm	**No**
Misconduct by A in relation to a member of the public while A is commuting to their firm's place of business for work	**No**
Misconduct by A in relation to a fellow member of the workforce when both are travelling to a meeting in which they will represent their firm	**Yes**
Misconduct by A in relation to a client at a business meeting in which A is representing their firm	**Yes**
Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by their firm	**Yes**

Description of Conduct	Does the conduct generally sit within the scope of COCON 1.1.6R to COCON 1.1.7R?
Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by A or another member of the workforce in their personal capacity	**No** However: 1. An occasion organised by a manager may be within the scope of COCON, taking into account that the manager's direct reports may feel obliged to attend 2. If the event takes place after a firm event but at a separate location or venue, it may be within the scope of COCON if it is a continuation of the first event or if the conduct started at the first event and continued in the new venue. Otherwise, COCON is likely to cease to apply because the connection between the event and the activities of the firm has been lost
Misconduct by A at a social occasion, a meeting, a round table, an awards ceremony, a training course or a workshop, in each case organised by a client of their firm, another firm, an industry body or a regulator, in which they will represent their firm or where the main reason for the invitation is their working for their firm	**Yes**
A is a member of a profession (such as an accountant, actuary or lawyer) and practises that profession in their job with their firm. A commits misconduct at an event organised by a third party to meet the professional requirements of that profession or by the regulator of that profession	**Yes**
A publishes material on a personal social media account (including sending it on a messaging app) held by A. As this table is just about whether conduct takes place in A's private life (and hence is outside the scope of COCON under COCON 1.1.6R to COCON 1.1.7R), this example assumes that the publication would otherwise breach COCON	This is an example of how it is not possible to give a definitive answer to a scenario based on a single element. Factors to take into account are: • whether the material is directed at a fellow member of the workforce (if it is, that points towards the conduct being within scope); • whether there is another connection between A and the subject of the misconduct that is not based on A's work with their firm (if there is such a connection, that may point away from the application of COCON); • whether it is part of a course of conduct that includes other incidents that are more closely connected with A's work at the firm; • whether the content of the social media posts is related to work at the firm; and • whether A uses a work-issued device. The fact that A uploads the posts during working hours or while on the firm's premises is not a strong factor pointing towards the application of COCON If the conduct takes place over the firm's systems (for instance through the firm's e-mail system) it is likely to be within the scope of COCON

3. THE MEANING OF "SERIOUS" (COCON 4.1.8EG)

COCON 1.1.7FR only covers conduct that is serious. The factors that the FCA will take into account when deciding whether misconduct in relation to a fellow member of the workforce is serious enough to amount to a breach of COCON include:

1. whether the conduct is repeated or part of a pattern;

2. the duration of the conduct;

3. the size of the impact on the subject of the conduct (the rule applies to effects which are serious and marked, and not to those which are, though real, of lesser consequence);

4. the seniority of the person whose conduct is in question;

5. the difference in seniority between the person whose conduct is in question and the subject of the conduct and whether the person whose conduct is in question has control or influence over the other's career;

6. whether the subject of the misconduct has specific characteristics or vulnerabilities, particularly if this is a factor in the conduct in question;

7. whether the person whose conduct is in question has been warned or disciplined for similar conduct by the firm, a previous employer, the police or a regulator;

8. whether the person whose conduct is in question has previously undertaken not to do the act or engage in the behaviour in question; and

9. whether the conduct is criminal or would justify dismissal.

4. FIT CONSIDERATIONS AND FRENSHAM COMPATIBILITY (FIT 1.3.18G)

In the FCA's view, misconduct of the type in FIT 1.3.17G can mean that the **person concerned is not fit and proper even if it cannot be shown** that the **misconduct will by itself cause direct and discernible damage to public confidence** in the financial system and financial services industry in the United Kingdom or to confidence in their firm on the part of customers or those who deal with the firm. As with other kinds of misconduct (see FIT 1.3.13G), it is sufficient if the misconduct is of a type that is inconsistent with the FCA's statutory objectives.

However, the underlined wording above appears to be at odds with the Upper Tribunal findings in *Frensham* v FCA [2021]. In Frensham, the Upper Tribunal criticised the FCA for making *"speculative and unconvincing"* attempts to link Mr Frensham's personal lack of integrity to his professional integrity. The Upper Tribunal also disapproved of the attempts to equate general moral failings with regulatory unfitness without establishing a sufficient evidential nexus to Mr Frensham's professional role or the statutory objective of maintaining public confidence.

On the one hand, the FCA's position in FIT 1.3.18G reflects a more expansive and preventative approach, enabling it to act where it believes that conduct (even in one's private life) is inherently incompatible with the integrity required of financial services professionals to maintain public confidence in the financial system and financial services industry. On the other hand, the Upper Tribunal's decision reflects a more constrained legal standard – one requiring that a *clear evidential link* be shown between the misconduct and statutory objective to maintain public confidence.

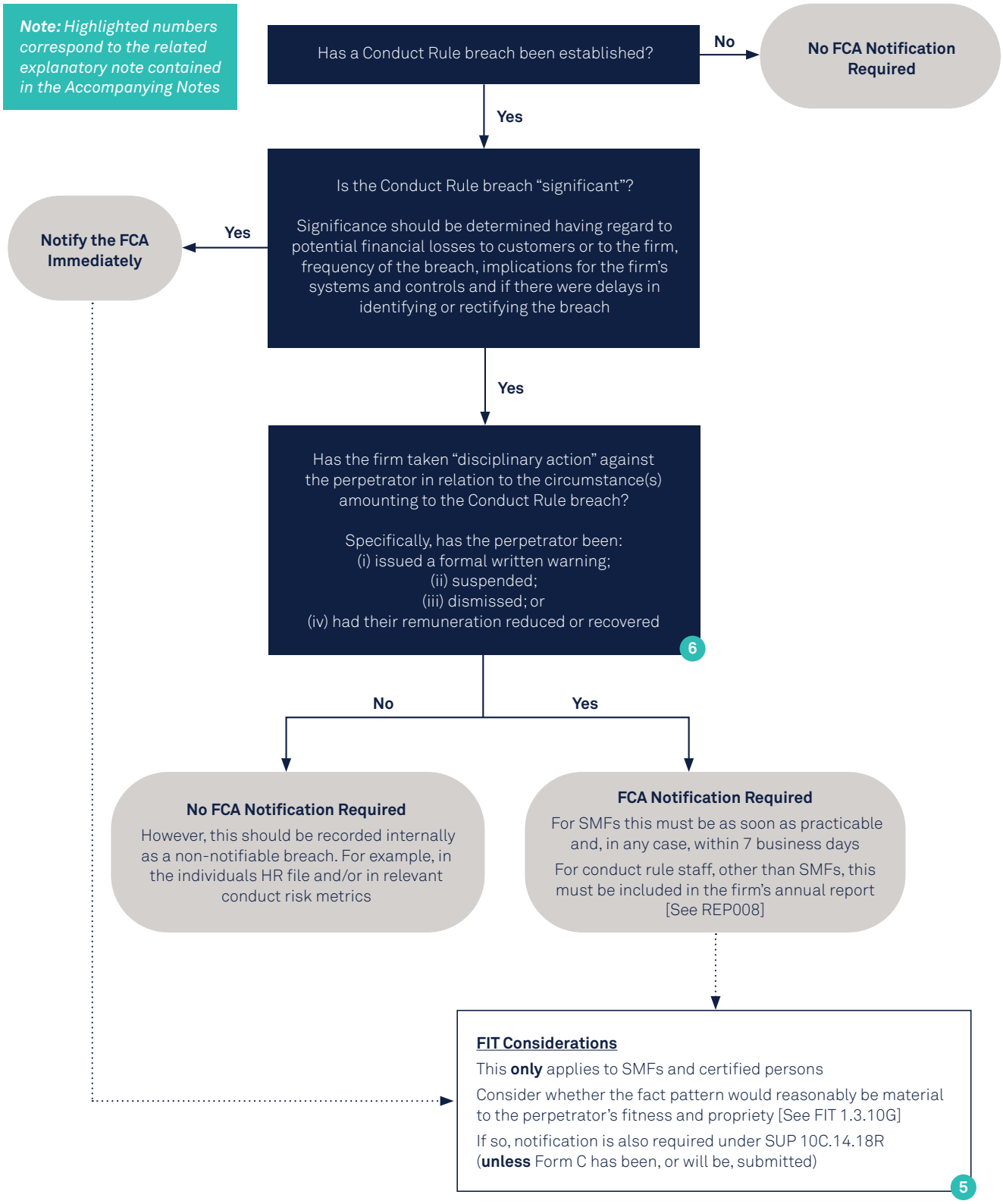
While FIT 1.3.18G signals the FCA's intent to widen its scope of review concerning personal integrity, firms should remain mindful that enforcement action will (if appealed) ultimately be subject to the oversight of the Tribunal, which we assume would follow its own findings in *Frensham*.

5. THE INTERLINK BETWEEN COCON BREACHES AND FIT IMPLICATIONS (FIT 1.3.10G)

A breach of the requirements of the regulatory system does not automatically mean that a member of the staff being assessed under FIT is not fit and proper. An assessment should be made on a case-by-case basis. In the case of COCON, relevant factors include:

1. the seriousness of the breach, taking into account matters such as the following (some of the other sub-paragraphs of this paragraph also contain factors relevant to seriousness):
   a) whether the breach involved dishonesty, breach of trust or violence;
   b) whether the individual knew that their conduct was a breach of COCON or their firm's internal requirements but carried on the conduct anyway;
   c) vulnerability of those affected by the breach;
   d) whether the breach was of Individual Conduct Rule 1 (You must act with integrity), although not every breach of that rule means that the individual is unfit;
   e) the harm done; and
   f) the factors in column (2) of row (A) of the table in SYSC 22.5.11G (Table: Examples of factors to take into account when deciding whether old misconduct is sufficiently serious to disclose);
2. how recent the breach was (the fact that the breach happened a long time ago may lessen the weight of that breach);
3. steps (including training) taken by the member of staff being assessed under FIT since the breach to address the behaviours involved in the breach or otherwise to address the causes of the misconduct;
4. (in the case of a breach caused by lack of competence) whether that lack has been remedied by subsequent training or experience;
5. other evidence of rehabilitation;
6. remorse and insight into the seriousness of the breach;
7. absence of the mitigating factors in (3) and (6);
8. the individual's past disciplinary record;
9. the individual's record of breaching COCON or other requirements of the regulatory system;
10. the individual's health and life events which may have caused them to act out of character;
11. whether the breach was reported or part of a pattern;
12. the seniority of the individual (the fact that the individual held a senior position may make the breach more serious than it would be if they held a junior position);
13. the likelihood of recurrence of the relevant conduct, for instance whether the conduct was a one-off lapse; and
14. the relevance of the breach to the role for which the member of staff being assessed under FIT is being assessed.

ANNEX 2
NOTIFICATIONS DECISION-TREE AND ACCOMPANYING NOTES



ACCOMPANYING NOTES:

Note: Each of the following sections corresponds to the related highlighted note in the Notification Flowchart.

5. THE INTERLINK BETWEEN COCON BREACHES AND FIT IMPLICATIONS (FIT 1.3.10G)

A breach of the requirements of the regulatory system does not automatically mean that a member of the staff being assessed under FIT is not fit and proper. An assessment should be made on a case-by-case basis. In the case of COCON, relevant factors include:

1. the seriousness of the breach, taking into account matters such as the following (some of the other sub-paragraphs of this paragraph also contain factors relevant to seriousness):

   a) whether the breach involved dishonesty, breach of trust or violence;

   b) whether the individual knew that their conduct was a breach of COCON or their firm's internal requirements but carried on the conduct anyway;

   c) vulnerability of those affected by the breach;

   d) whether the breach was of Individual Conduct Rule 1 (You must act with integrity), although not every breach of that rule means that the individual is unfit;

   e) the harm done; and

   f) the factors in column (2) of row (A) of the table in SYSC 22.5.11G (Table: Examples of factors to take into account when deciding whether old misconduct is sufficiently serious to disclose);

2. how recent the breach was (the fact that the breach happened a long time ago may lessen the weight of that breach);

3. steps (including training) taken by the member of staff being assessed under FIT since the breach to address the behaviours involved in the breach or otherwise to address the causes of the misconduct;

4. (in the case of a breach caused by lack of competence) whether that lack has been remedied by subsequent training or experience;

5. other evidence of rehabilitation;

6. remorse and insight into the seriousness of the breach;

7. absence of the mitigating factors in (3) and (6);

8. the individual's past disciplinary record;

9. the individual's record of breaching COCON or other requirements of the regulatory system;

10. the individual's health and life events which may have caused them to act out of character;

11. whether the breach was reported or part of a pattern;

12. the seniority of the individual (the fact that the individual held a senior position may make the breach more serious than it would be if they held a junior position);

13. the likelihood of recurrence of the relevant conduct, for instance whether the conduct was a one-off lapse; and

14. the relevance of the breach to the role for which the member of staff being assessed under FIT is being assessed.

6. SUSPENSION AND RECOVERY OR REDUCTION OF REMUNERATION IN THE CONTEXT OF A COCON BREACH

As part of a consultation on measures to improve the efficiency and effectiveness of the Senior Managers & Certification Regime (CP25/21), the FCA proposes to add guidance to further support firms in considering how to apply the Conduct Rules.

The FCA has proposed guidance to clarify that where the reason for a suspension is to **remove someone from work before an investigation into a potential Conduct Rule breach has concluded**, rather than as a sanction resulting from the breach, then this **would not be reportable** as a Conduct Rule breach under SUP 15.11. This would avoid potentially unfair consequences for individuals that are suspended due to a suspected Conduct Rule breach, and a subsequent investigation concludes that there was no breach or that the breach was not serious enough to require disciplinary action.

Similarly, the FCA proposes to include guidance that where a person's remuneration has been reduced or recovered, **firms should only report** under SUP 15.11 **if the reason for the reduction or recovery was a sanction** arising from a Conduct Rule breach. Firms may adjust remuneration in a range of circumstances, including for example in cases of poor firm or business unit performance where the individual would not be considered "personally culpable", as per the definition in COCON 3.1.3.

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